No. 63

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1939

---

V. L. LETULLE, *Petitioner,*

v.

FRANK SCOFIELD, UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF TEXAS

---

## ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

---

## REPLY BRIEF OF PETITIONER

---

W. E. DAVANT,
HOMER L. BRUCE,
*Attorneys for Petitioner.*

# INDEX



# AUTHORITIES

No. 63

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1939

V. L. LeTULLE, *Petitioner*,

v.

FRANK SCOFIELD, UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF TEXAS

## ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

## REPLY BRIEF OF PETITIONER

We desire to file this brief reply to the brief in opposition by the respondent because of what we feel are many inaccurate statements by respondent as to the record and inferences to be drawn therefrom. If respondent's brief alone is read without any explanation, an entirely erroneous view of petitioner and his complaint unfortunately will readily be obtained.

At the outset we call attention to the status in this record of respondent's motions for continuance and for a new trial and the many exhibits attached thereto. These motions were overruled by the trial court, and, when respondent appealed to the Circuit

Court of Appeals, that court overruled his assignments of error on that point. They were in the record solely because of his exceptions to the trial court's action. Now that he has acquiesced in their being overruled by not appealing to this Court, they have no material place in the record and may in no way be relied upon by respondent. Yet he devotes two pages of his statement detailing their contents (Brief, pages 6 to 8), and relies in his argument upon inferences to be drawn from them and their ex parte statements, and thereby builds up a very unfavorable picture of petitioner.

Likewise, as will be further pointed out later, respondent by inference attempts to use these motions to supplement his answer and cure his failure to plead the defense that he was required to plead affirmatively.

The transaction involved was simple and had none of the earmarks of "sham or subterfuge" that respondent asserts.

The case was simply as follows, both actually and as borne out by the entire record, including respondent's motions. Petitioner owned all the stock of the Gulf Coast Irrigation Company and also some irrigation properties personally. Gulf Coast Irrigation Company and Gulf Coast Water Company entered into a plan of reorganization of November 4, 1931, under which the Irrigation Company agreed that it would, after obtaining title to all the properties, transfer them to the Water Company for cash and bonds. Petitioner joined in the agreement not for the purpose of selling his own prop-

erties, but for his individual agreements to warrant personally the titles and similar collateral agreements on his part. Petitioner transferred his properties to the Irrigation Compay for stock and thereafter the Irrigation Company transferred the properties to the Water Company for cash and bonds. It immediately dissolved and distributed all its assets to petitioner in cancellation of its stock. The government ruled that the bonds were not securities and therefore the transfer was a taxable sale and the distribution to petitioner was taxable. It accordingly assessed a corporation tax against petitioner as transferee of the Irrigation Company and an individual tax on him personally. Petitioner sued to recover on the ground that as to the bonds both the transfer and distribution were tax free. The respondent pleaded only a general demurrer and general denial and contested petitioner's claim in both lower courts on the sole ground that bonds are not securities within the tax free reorganization sections. The Circuit Court held they were securities and overruled all of respondent's contentions, but on its own motion held the transfer by petitioner of his properties to the Irrigation Company was a device to evade taxes and as to those properties it would disregard the Irrigation Company and treat them as being sold directly by petitioner to the Water Company.

Respondent's version of the facts as set out in his statement is as follows: Prior to the above mentioned agreement on which the transfer was closed, the Irrigation Company and petitioner had made

a contract with Continental Service Company under which the Irrigation Company and petitioner each sold their separate properties to the Continental Service Company, that the corporate minutes showed this sale to have been kept alive and the final transfer was closed on that contract, and the agreement of November 4, 1931, on which petitioner relies, was entered into merely for the purpose of calling the transaction a reorganization for the sole and exclusive purpose of attempting to evade taxes. He then states petitioner had disposed of his own properties by this outright sale. His statement then concludes (Brief p. 8):

> "The Circuit Court of Appeals did not regard the denial of the Government's motions as error, but instead, *on the basis of the facts established by the evidence in the record*, reversed the judgment of the trial court insofar as it had applied the reorganization provisions to the properties individually owned by the taxpayer at the time the contract was entered into." (Italics ours.)

This statement occurring, as it does, immediately after respondent's detailed analysis of its motions, it seems to us that respondent's position is that the Circuit Court of Appeals based its action not only on the actual evidence but also upon that contained in respondent's motions. If such is the case, then of course it was palpable error for the lower court in any way to consider those motions.

It seems to us that respondent at least is attempting to give this Court the view that the actual

transaction was not as shown by the admitted evidence, and thus place petitioner in as unfavorable a light as possible.

The following were the facts concerning the prior contract as shown by the evidence and respondent's motions, the motions for this purpose being taken as true.

As respondent states on pages 6 and 7, petitioner testified that he had a prior contract for the sale of these properties. Respondent then states that the corporate minutes showed that the prior contract was kept alive and the final contract was made for tax evasion purposes. The history of the prior contract, as set out by respondent's motions, was as follows:

On November 5, 1930, petitioner and the Irrigation Company made a contract with B. E. Buckman and Company under which they agreed to convey or cause to be conveyed certain properties "now owned by Gulf Coast Irrigation Company" (R. 217) for $200,000 *in cash* (R. 221) upon approval of titles and $600,000 in notes maturing over a period of twelve years. This contract and other properties were transferred on December 16, 1930, to Continental Public Service Company (R. 238). That Company on January 21, 1931, transferred the contract to Central West Water and Power Company for $500,062.50, represented by the latter's note, that Company assuming the obligation to pay Gulf Coast Irrigation Company the $800,000 (R. 240). In September, 1931, Central West Water and Power Company transferred the contract to Gulf

Coast Water Company, which assumed the $800,000 obligation and gave the Central Company its note for $525,062.50 (R. 242).

It will be noted that the corporate minutes respondent refers to are those of only Gulf Coast Water Company and its predecessors in title and its apparently associated companies. There is not one scintilla of evidence that petitioner knew anything about those minutes or had any connection with those intercompany transactions. The truth of the whole situation is obvious. Buckman and Company transferred the contract to Continental Public Service Company for a large amount of that company's stock. (R. 238). That Company transferred it for $500,062.50 to Central West Water and Power Company (R. 241), which in turn transferred it for $525,062.50 to Gulf Coast Water Company (R. 242). When those companies failed to carry it out and it was cancelled and a new contract had to be made, they for their own corporate purposes had to give support to the more than $500,000 they paid each other for the contract and so built up their intercorporate records in this manner. But, as stated above, petitioner had nothing to do with any of those wholly unilateral transactions.

The truth is Gulf Coast Water Company could not carry out the first contract and both petitioner and E. J. Crofoot, President of Gulf Coast Water Company, both testified that the old contract was wholly done away with and the new one of November 4, 1931, was executed, but respondent has wholly

failed to mention that fact to this Honorable Court.

Petitioner testified (R. 178):

"We had that contract; Mr. Davant drew it up. It was with the Continental Service Company. That was before this contract here was made and they were not able to carry it out and then we wrote up another contract and that is the contract the deal was closed on. I do not know who the other contract was by name, whether it was the Continental Public Service or Mr. Crofoot or who made that, but Mr. Davant can state and explain all that to you; if you want to know anything about it, he has been my attorney for a long time. I received a payment of $10.00 on that contract of January, 1931; and gave it back to them when we entered into the other contract. I would not swear to the date of the contract, some time in 1931; I do not know whether it was in the early part or not; the records will show when it was, I do not remember. I did not receive anything on the first contract; there was no contract made entirely because they were not able to carry out the first contract, at least they did not do it, but I don't know why. I do not know why they didn't go on with the contract; we tore up that contract and wrote another one. I received payment in bonds on this contract here, that Mr. Bruce had a while ago."

E. J. Crofoot testified:

"I heard the testimony and know of this transaction in November, 1931, whereby the Gulf Coast Irrigation Company transferred its assets to the Gulf Coast Water Company. At that time I was connected with the Gulf Coast Water Company; I was the President of the Company; I attended to the issuance of the

bonds at the time (R. 179). * * *

"I heard the testimony of Mr. LeTulle that he entered into a contract with the Continental Public Service Company in 1930, that is between the Gulf Coast Irrigation Company and the Public Service Company, but I do not remember that particular contract. I do not remember that contract at all. There was a contract between B. E. Beckmann & Company and the Gulf Coast Irrigation Company; my recollection is that was in December, 1930, some time (R. 180).

"With reference to the contract Mr. Gibson was talking about, this old contract in 1931, this final contract did away with all prior contracts that we had. It is correct that the old contract was thrown away and we went into an entirely new and different contract altogether (R. 181)."

In the face of this positive and unequivocal testimony of the Presidents of both companies involved, respondent's brief is replete with inferences, insinuations and arguments that really the old contract was always in effect and actually petitioner sold his individual properties directly to the Water Company and in substance the holding of the Circuit Court of Appeals was in fairness and in equity correct.

There was a very concrete reason why the Water Company could not carry out the first contract. It called for the payment by the Water Company of $200,000 in cash upon the closing of the purchase and $50,000 a year for twelve years (R. 221). The final contract of November 4, 1931, called for only $50,000 in cash and $750,000 in bonds over a period

running to January 1, 1944, the first bonds maturing January 1, 1933, approximately fourteen months after the contract (R. 77). As the Circuit Court of Appeals pointed out (R. 286), the Water Company had no independent financial strength and, if the properties were successful, it could pay the bonds, otherwise not. Under these circumstances, it was a far different story for the parties backing the Water Company to risk only $50,000 in cash rather than $200,000.

Running all through respondent's brief is the inference that petitioner never transferred his properties to the Irrigation Company but that they passed directly from him to the Water Company.

On page 14 petitioner states that under the original contract petitioner "was to acquire the property owned by the old corporation and to transfer it along with his own property in an outright sale." He then states on page 15 that after the final contract was signed "a deed was executed by the corporation and by the taxpayer individually transferring the properties so combined to the new corporation. The record fails to show any transfer of the property from the taxpayer to the Irrigation Company." Respondent harps on this last statement of no transfer of petitioner's properties to the Irrigation Company. See his brief, pages 6, 10, 13 and 15. He even questions the existence of any such transfer in his statement of the question presented (Brief p. 2).

The true facts are as follows: The original contract with B. E. Buckman and Company, as pre-

sented by respondent (R. 217) did not cover petitioner's individual properties at all. A reference to that contract on page 217 shows that the Irrigation Company and petitioner contracted to convey or caused to be conveyed "all of the pumping plants, intakes, pumps, machinery, canals, flumes, laterals, leads, ditches, rights-of-way of canals and laterals and water rights, personal property *now owned by Gulf Coast Irrigation Company*" and certain contracts held by that Company. By the final contract (R. 76) the Irrigation Company recited it owned certain properties, using the identical words above quoted to describe them, and that "prior to the conveyance hereinafter called for to be executed will be the owner of *certain other lands and irrigation properties,*" all of the properties to be conveyed being described on Exhibit A. Then the contract recited (R. 77) that "Irrigation Company hereby agrees that *it* will convey the properties described in Exhibit A to the Water Company," but it did not provide for any conveyance by petitioner to the Water Company.

The above shows that the first contract made no reference to any properties owned by petitioner but was confined to those then owned by the Irrigation Company. Likewise, that contract called for their conveyance by the Irrigation Company to the Water Company and not, as respondent states, for the Irrigation Company to transfer them to petitioner and then for him to sell them and his own properties to the Water Company.

Yet petitioner still infers that petitioner did not

transfer his individual properties to the Irrigation Company but that his title passed directly from him to the Water Company by the deed from the Irrigation Company in which petitioner joined. The facts are just the contrary. The contract provided (R. 87) that petitioner should join in any deed for the purpose of personally warranting the titles and making the personal agreements called for, as, for example, not to engage in the irrigation business for thirty years. The deed itself (R. 110-112) recites that the Irrigation Company has granted and conveyed to the Water Company the properties involved. It then recites (R. 111) that "V. L. LeTulle joins in the execution of this deed, for the purpose of warranting title to the properties hereby conveyed to Grantee and entering into and making the covenants and agreements hereinafter contained." There is not a single word in that deed whereby petitioner purported to convey any title to the Water Company, but it was solely a conveyance by the Irrigation Company.

Petitioner did not introduce any abstract of title or other muniments to show how he conveyed his properties to the Irrigation Company. The record showed he conveyed them for stock in that company. The Water Company examined the titles and was sufficiently satisfied with the conveyance from only the Irrigation Company to pay out the $50,000 in cash and deliver the $750,000 of bonds. These facts refute the repeated statements of respondent on this feature.

In reference to the pleadings and authorities as discussed by respondent, there are similar attempts by respondent to justify the judgment of the Circuit Court of Appeals.

Now, at the time the properties were transferred by the Irrigation Company to the Water Company, they were wholly owned by the Irrigation Company and their transfer to the Water Company came squarely within Section 112 (i) (1) (A) of the 1928 Revenue Act defining a reorganization as "including the acquisition by one corporation of * * * substantially all the properties of another corporation." When this was shown by petitioner, respondent attacked it only on the ground that bonds are not securities. The Circuit Court of Appeals, as shown by respondent on page 11 and 12, reversed the case on the ground never raised by the government that, as to petitioner's properties, this was a mere device resorted to by petitioner. The respondent, although admitting on page 11 that the lower court "rejected the theory upon which the Government sought to meet this issue," yet contends that this issue was raised under the general proposition that petitioner must show the transaction came within the reorganization provisions. This the petitioner did, and if the government desired to avoid this on the ground of its being an alleged device, the burden was upon it, under the authorities cited in our original brief, to plead this as an affirmative defense. And we are unable to come to any other conclusion than that one of the

real purposes of respondent in dwelling at such length upon his motions for continuance and new trial was to try in this way to say that it had affirmatively pleaded that issue. It is obvious that such motions may not be used to supplement his pleadings and cure this defect therein.

We still contend that the rule announced by this Court in *General Utilities v. Helvering,* 296 U. S. 200, is applicable here and the decision of the lower court in this case is in direct conflict with it. Just as the Circuit Court of Appeals in that case, as respondent admits on page 10, on its own motion held the transaction a sham, here the lower court held petitioner's transfer was a mere device. In that case this Court squarely held that ground for reversal was not before the lower court as not raised by the Commissioner, and we cannot see how this "device" defense was available to the court below in this case.

The decisions of neither the Circuit Court of Appeals nor of this Court in *Gregory v. Helvering,* 293 U. S. 465, 69 F. (2d) 809, are in point, either on the question of pleading or on the merits. There the taxpayer owned all the stock of United Mortgage Corporation which in turn owned stock in Monitor Securities Corporation. The taxpayer wanted to sell the Monitor stock. However, if United made the sale, it would be subject to a corporation tax, and in addition if the proceeds were distributed as a dividend, the taxpayer would be subject to the normal and surtax rate. She there-

fore had United organize the Averill Corporation, transfer the Monitor stock to Averill in payment for all of its stock which was issued to the taxpayer. She three days later dissolved Averill and received the Monitor stock on the liquidation. She then contended that she received the Averill shares in a tax free reorganization, that she received the Monitor shares under section 15(c) of the 1928 Act as an exchange for her Averill shares, and was taxable at the lower capital gain rate on the value of the Averill shares less certain applicable costs. The Commissioner disregarded the whole transaction and held it was merely a dividend of the Monitor shares and assessed a normal and surtax tax on the value of the *Monitor shares*. The taxpayer appealed to the Board of Tax Appeals and the Commissioner affirmatively raised that defense. Losing before the Board, the Commissioner appealed on the same grounds. The Circuit Court of Appeals substantially sustained the Commissioner but said that it would recognize all the steps taken but treat them as a sham and the tax should be computed on the value of the *Averill shares* received as an ordinary dividend instead of on the value of the Monitor shares. Since the value of the Averill and Monitor shares were identical, the tax was the same. Clearly there the Circuit Court of Appeals was deciding the case on exactly the grounds raised by the Commissioner, namely, that the whole transaction was a sham and had no reality. It merely held the Averill shares were the measure of the

income received and not the Monitor shares. On the other hand in the present case the lower court raised the "device" issue itself when the government never at any time before or after suit ever dreamed of it.

This Court affirmed the *Gregory case* as the transaction was a mere scheme to avoid taxes.

*Helvering v. Bashford,* 302 U. S. 454, and *S. A. McQueen Co. v. Commissioner,* 67 F. (2d) 857, need no comment as a mere reading of them will disclose.

In the present case there was absolutely no scheme or device or idea of evading any taxes. As we point out in our main brief, the Irrigation Company could have transferred its original properties to the Water Company for bonds and distributed them to petitioner in a tax free reorganization and he would have paid his income tax thereon as he collected the bonds. He could at the same time have sold his individual properties directly to the Water Company and paid his taxes thereon on the installment basis only as he collected them. If he had done this, as we have shown in Appendix B, he would have paid less taxes for 1931 than he actually did. As shown on pages 18 to 20 of our original brief, there were valid business reasons from petitioner's standpoint why the transaction should be carried out as it was, regardless of any incidence of taxation.

In this connection, the term "tax free reorganization" is a misnomer and often creates the er-

roneous impression that the payment of taxes are being escaped. These reorganization provisions are not loopholes or means of avoiding taxes, but merely apply the same principle available to individual sellers of property on a deferred or installment basis under Section 44 (a) and (b) of the 1928 Revenue Act and similar provisions in other Acts. In each case the Government merely postpones collecting the tax until the taxpayer actually receives cash or its equivalent for his paper securities. In this case, petitioner recognizes that, as his bonds are paid off, he will have income taxes to pay.

We request the Court to consider the serious consequences to petitioner if the decision of the Circuit Court of Appeals stands. The Commissioner held that the Irrigation Company made an outright sale of all the properties and levied a corporation tax on that entire transaction, which taxpayer as transferee of its assets on liquidation paid. He then treated the distribution of the bonds to petitioner and his wife as a wholly taxable dividend and levied high personal taxes on them, which petitioner paid. The Government's only contention was that this was a sale because only bonds were involved and no stock. The Circuit Court of Appeals has now held that as to the original properties of the Irrigation Company it was a tax free reorganization, but petitioner's individual properties must be treated as having been sold directly by him to the Water Company, and remanded the case for further proceedings consistent with its opinion (R.

287). If petitioner is required to return to the trial court with this state of the record, it seems to us he will probably have the burden of apportioning the $800,000 consideration between the Irrigation Company's original properties and his own individual ones. We anticipate the most strenuous objections on the part of the Government to any attempt to make such apportionment on the ground that all the properties were sold for a lump sum of $50,000 cash and $750,000 in bonds. If no such apportionment can be made, then petitioner will recover nothing with the result that he will have paid far more taxes than the Government was ever actually entitled to. With this the condition of the record, it is not surprising that the Government, although both lower courts overruled every ground of opposition presented by it, has been content to rest on the decision of the Circuit Court and has not applied to this Court for a writ of certiorari.

We respectfully pray that the petition for writ of certiorari be granted.

W. E. DAVANT,
HOMER L. BRUCE,
*Attorneys for Petitioner.*